TIME WARNER

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June 25, 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

Re: Docket No. 96-98

Dear Mr. Caton:

On June 25, 1996, Janis Stahlhut and Don Shepheard of Time Warner Communications and the undersigned met with James Schlichting, Richard Lerner and Leslie Selzer of the Common Carrier Bureau to discuss issues in the above-referenced proceeding. The attached document was distributed in the meeting and summarizes the matters addressed.

Sincerely yours,

Carol Melton

Carol A. Melton

cc: James Schlichting
Richard Lerner
Leslie Selzer

enc.

TELECOMMUNICATIONS ACT OF 1996
IMPLEMENTATION OF LOCAL COMPETITION

1. PRICING STANDARDS

2. MUTUAL TRAFFIC EXCHANGE

3. UNBUNDLED ELEMENTS & ACCESS SERVICES

4. STATE IMPOSITION OF SECTION 251(C) REQUIREMENTS ON CLECS

TELECOMMUNICATIONS ACT OF 1996
IMPLEMENTATION OF LOCAL COMPETITION

PRICING STANDARDS

The Section 252 Pricing Standards differentiate among the facilities/services required by the various classes of competitor (See Chart)

- Interconnection & Network Elements - Section 252 (d)(1)
  - Based on Cost: Economic Standard (TSLRIC)
  - Reasonable Profit: Policy Standard
    - Policy considerations should differentiate between essential and non-essential facilities

- Transport and Termination - Section 252 (d)(2)
  - Based on Additional Costs: Economic Standard (LRIC)
  - Call Termination represents a permanent "last bottleneck"
  - While the NPRM suggests that the pricing standard for transport & termination could be the same as for interconnection & network elements, the statutory language and economics of the competitive business suggest that there is a legitimate differentiation.

- Resale - Section 252 (d)(3)
  - Retail rates less avoidable costs
  - Avoidable cost standard must consider <u>net</u> avoided costs. Wholesale prices must reflect costs of wholesale functions (billing, collections, customer services, etc.)
  - Artificially-contrived discounts that fund artificially-low rates change the economics of building competitive facilities
    - IXCs have attempted to exclude legitimate wholesale costs to justify steep discounts
    - IXCs' strategy has more to do with long distance competition than local competition. Looking for steep discounts to fund a "pre-emptive strike" against RBOCs in form of local service price war. (See *Wall St. Journal*, 5/30/96)
  - Relationship of the "cost of interconnection" to the "cost of resale" could potentially deter facilities-based investment decisions.

MUTUAL TRAFFIC EXCHANGE

Adopting a Mutual Traffic Exchange approach will help achieve Congress' goal of rapidly establishing competition in the local exchange marketplace

- Mutual Traffic Exchange satisfies requirement for "mutual and reciprocal recovery" of costs by each carrier
- Mutual Traffic Exchange is not a system of *free* interconnection. It provides each carrier with a tangible economic benefit in lieu of a cash payment.
- Economically efficient where traffic is relatively in balance and long-run incremental costs are *de minimus*.
  - Competitors in mass market can be expected to attract a normal sample of the population segment, resulting in relatively balanced traffic.
  - Avoids Transaction costs which impose a relatively greater burden on new facilities-based entrants. Transaction costs could exceed benefits of compensation rate.
  - Compensation rates provide economic incentive to skew traffic balance.
- An alternative to pure Mutual Traffic Exchange would be to apply compensation rates only to traffic outside a specified **"zone of balance."**
  - Recognizes that *de minimus* differences in terminating traffic do not justify the onset of transaction costs.
  - Where traffic imbalance exceeds a threshold level, party with greater amount of traffic receives cash payment.

Commission rules should require parties to negotiate a Mutual Traffic Exchange arrangement which allows each party to manage their respective risk.

- There should be an initial period of pure mutual traffic exchange (9-12 months).
- Threshold over which compensation rates apply should take into consideration transaction cost levels, as well as conditions contributing to out-of-balance traffic (e.g., interim number portability).

UNBUNDLED ELEMENTS & ACCESS SERVICES

Rules for unbundled network elements should not economically deter facilities-based competition.

- IXCs seek to recombine network elements at TSLRIC prices to avoid Section 251(c)(4) Resale. If allowed, will tend to foreclose meaningful facilities-based competition.

- Switch Platform proposal provides little incentive for investment in switching facilities.
  - Provides all the benefits of switch ownership without any of the risk of underutilized capacity.
  - IXCs seek LEC economies-of-scale at TSLRIC prices.
  - Congress did not intend to eviscerate the Part 69 access charge rules.

- Definition of network element in the Act does not preclude charging for features, functions and capabilities on a usage basis.
  - "...a facility or equipment used in the provision for a telecommuncicatiions service. Such term also includes <u>features, functions, and capabilities that are provided by means of such facilities or equipment</u>..." [Sect. 3(a)(45)]

STATE IMPOSITION OF SECT. 251(C) REQUIREMENTS ON CLECS

States cannot impose Section 251(c) requirements on non-incumbent LECs.

- Only the Commission may rule for treatment as an incumbent LEC in accordance with the conditions set out in Section 251(h)(2).

- The Commission's Order in Docket 96-98 needs to affirm this provision to avoid petitions for preemption.

TELECOMMUNICATION ACT OF 1996
SECTION 252 PRICING STANDARDS

STATUTE REFERENCE	FACILITIES	STATUTORY REQUIREMENT	PRICING STANDARD
SECTION 252(d)(1)	INTERCONNECTION and NETWORK ELEMENTS	1.) BASED ON COST and 2.) REASONABLE PROFIT	TSLRIC POLICY
SECTION 252(d)(2)	TRANSPORT & TERMINATION (Call Completion)	MUTUAL & RECIPROCAL RECOVERY OF COSTS BASED ON *ADDITIONAL COSTS* OF CALL TERMINATION	LRIC
SECTION 252(d)(3)	FULL SERVICES	RETAIL RATES LESS AVOIDABLE COSTS	WHOLESALE

AT&T Discounts Signal a National Price War

By John J. Keller
Staff Reporter of The Wall Street Journal

The war over local telephone service has begun.

AT&T Corp., taking the offensive to foil local phone companies aiming to capture its long-distance business, is preparing pre-emptive discount pricing for local phone service in numerous U.S. markets.

The first of these pricing moves came yesterday in the Illinois market controlled by Ameritech Corp., a Baby Bell. AT&T said it would offer new customers three months of free, unlimited "local-toll" calling in the Illinois region. These toll calls go beyond a local market without crossing long-distance boundaries. AT&T also said that it would extend deep discounts on its local rates thereafter and that customers could apply their local-toll calls to their current AT&T discount plans, giving them even larger discounts on long-distance service.

AT&T already offers cheap toll calls in California and New York, but the plan unveiled yesterday is one of the first to offer free calling to lure newcomers – and it presages further offensive maneuvers.

"In competitive markets you can only be aggressive, giving the customers value, or you will lose," says Joseph Nacchio, AT&T's president of consumer services. Noting the new competition for AT&T's long-distance customers, Mr. Nacchio vows that "we will be the market leader when the dust settles – and will be as aggressive as necessary to get there."

In Connecticut, AT&T is contemplating new price cuts as a way to thwart the

TELECOMMUNICATIONS

Key AT&T Battlegrounds

[illegible]	STATUS	COMPETITION
[illegible]	Nation's largest service	MCI, Sprint, WorldCom, and numerous smaller regional carriers. In the future, the regional Bells, GTE and smaller local phone companies
[illegible]	Filed to enter all 50 states. Current hot spots: Illinois, Michigan, California, New York and Texas.	Ameritech, SBC-Pacific Telesis*, Bell Atlantic-Nynex*
[illegible]	Nation's largest service, covers 30% of the country and plans to expand to 80% within two years.	Bells, GTE, Sprint and newer PCS services
[illegible]	AT&T WorldNet service aimed at other Internet and on-line offerings.	America Online, Netcom, MCI and others.
[illegible]	AT&T to begin selling direct-broadcast service nationwide this summer.	Entrenched cable-TV operators, MCI-News Corp. and other DBS operators
[illegible]	Data and network facilities management	IBM, EDS, Andersen Consulting and MCI

*Planned mergers, each uniting two Bell regional territories
Source: AT&T and analyst reports

surprising success that the local service provider, Southern New England Telecommunications Corp., has had in selling long-distance service to state residents. SNET already has grabbed 15% of the long-distance market in the state from AT&T and others – raising the alarming prospect for AT&T of losing a similar share in other states as the Baby Bells begin long-distance business. So AT&T is weighing whether to offer Connecticut customers a flat rate of five cents per minute on all calls – long-distance, local or toll service. That would amount to less than half the current discounted rates.

The latest moves indicate that the first big battleground in the new era of phone competition, brought about by the telecommunications deregulation law passed earlier this year, will be in local-toll calls. Ultimately, the richest terrain to capture will be long-distance, a $70 billion market, and regular local service, a $100 billion business.

But neither will be easy pickings: The seven Baby Bells must meet a "checklist" of requirements to ensure they have opened their local monopoly to competition before being allowed into long-distance, which could take some of them two years or more; in local service, new rivals must rent local lines from the Bells and other monopolies or, in a costly and less likely strategy, build local networks of their own.

For AT&T, the freebie offer in Ameritech country and the planned action in Connecticut most likely reflect a resolve to protect its long-distance base of 90 million customers by keeping its new rivals busy protecting their own turf. In long-distance, AT&T currently has an edge with consumers and roughly a 60% share.

In recent years, the prices of long-distance service from the big three providers – AT&T, MCI Communications Corp. and Sprint Corp. – have usually differed by about a penny or two a minute. That is bound to change once new long-distance entrants such as the Bells come in. AT&T appears to have anticipated that challenge – by cutting prices on the local front rather than coming up with yet another discount plan in long-distance.

Holding on to customers is crucial as the telecom rivalry heats up and AT&T and other carriers move toward offering a bundle of local, long-distance, wireless and video services. Such packages could help AT&T retain customers without

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expensive marketing, including such common enticements as $100 checks. AT&T and its rivals in long-distance currently spend more than $10 billion annually to sell service.

Ameritech has become AT&T's first major target because, among the Bells, it is one of the farthest along in meeting the checklist that would allow it to invade AT&T's turf. AT&T's offer of free service runs Aug. 1 to Oct. 31 and covers calls that travel more than 15 miles in Illinois but remain in the local toll calling area. The Chicago-based Bell seemed to welcome AT&T's offer – in part because the local competition could help Ameritech get into the long-distance market even sooner. "Free seems like pretty aggressive competition to me," says an Ameritech spokesman, noting that Ameritech offers toll-calling discounts but no free service.

In addition to the free offer, AT&T is revising its rates in Illinois. Under this new plan, a five-minute call between Chicago and suburban Glenview would cost up to 21% less than Ameritech's basic local-toll rates, AT&T says.

With their monopoly control of most local customers and phone lines, the Bells and GTE Corp. could inflict deep wounds in AT&T's long-distance franchise. AT&T, after spinning off its NCR computer business and Lucent equipment unit to shareholders, will be left with a core long-distance business that generates some $50 billion in annual revenue.

Meanwhile, AT&T watchers say the company has had a huge increase in customer turnover – the so-called churn rate. One person who has seen the numbers says AT&T's churn in the past five months "is up 35% to 40% over the company's last all-time high" in mid-1994.

Mr. Nacchio says, "Industry churn is up, therefore ours is up. . . . There are 500 companies in the U.S. selling long-distance services now."